



STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

April 1998

To the People of the State of New York:

This report addresses an issue that is almost always the subject of a question when I meet with New Yorkers: "Isn't lottery money supposed to provide extra aid for education?"

The answer, as with anything involving government accounting and budgets, is complex. Lottery receipts are indeed deposited into a special fund, and that fund is used for education. In reality, however, the lottery is simply part of the pool of resources that is divided among various competing needs in the state budget process. This report, for example, documents past budget actions that simultaneously increased lottery receipts and yet reduced support for education.

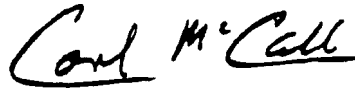
When the lottery was approved in the early 1960s, the public was promised that it would support education. Implied in that promise was that the lottery would add to state aid, rather than merely replace it. Even today, a new lottery advertising campaign perpetuates the myth that schools receive additional resources from the lottery. The truth is that the Legislature and Governor decide how much state aid will go to local schools and the amount from the lottery is just a small part of that total. Lottery money has never supplemented state aid; it doesn't today and it likely never will.

In New York, as in many other states, lottery earnings have been earmarked for education primarily as a public relations device. The opposition that arises from the use of gambling proceeds to fund government services is deflected by pointing to the worthy purpose that the lottery funds.

The lottery accounts for a relatively small share of state resources directed to education, and it is unlikely that any budget practice could be devised that would ensure that the lottery would provide additional support. The creativity used to balance past budgets would certainly be used to thwart any such measure.

The real debate in school finance should focus on whether our school aid system is equitable and efficient. I have issued a series of reports *over the* past two years that document *serious* problems with the state's education financing policies and suggest reforms to address them.

Sincerely,

A handwritten signature in black ink that reads "Carl McCall". The signature is written in a cursive, flowing style.

H. Carl McCall,
State Comptroller

THE NEW YORK LOTTERY

Role in Financing Education

April 1998



H. Carl McCall
State Comptroller

*State of New York
Office of the State Comptroller
Office of Fiscal Research & Policy Analysis
Albany, New York 12236*

In an effort to reduce the costs of printing, please notify the Office of Fiscal Research and Policy Analysis at (5 18) ~~474-4481~~ if you wish your name to be deleted from our mailing list or if your address has changed.

Additional copies of this report
may be obtained from:

Office of the State Comptroller
Public Information Office
Governor Smith State Office Building
Albany, New York 13236

(5 18) 474-40 15

Or through the Comptroller's World Wide Web site at: www.osc.state.ny.us

Executive Summary

This report reviews the role of the lottery in New York's finances, focusing on its contribution to public schools. The debate on the lottery in the Legislature and the media is summarized and is put in context by reviewing the state's economic and political climate at the time of lottery authorization. The sources of school district revenue are analyzed over time to describe the shifting shares contributed by school aid, the federal government, lottery and property taxes. The use of lottery funds as a means to balance past budgets is described. Finally, the prize structure of each of the existing lottery games is described.

Lottery as a Revenue Source

The New York lottery provides an important source of revenue to the state: \$1.6 billion in state fiscal year 1996-97, accounting for 3.7 percent of state funds spending. School aid spending, however, is much larger. In 1996-97, the major school aid program totaled over \$10 billion, accounting for 24 percent of state funds spending.

The lottery also accounts for a **small** share of the resources of local school districts, contributing only 5.3 percent of all revenue sources in school year 1995-96, substantially below the 50 percent contribution of property taxes and slightly below the 6 percent contributed by the federal government.

Dedication: Supplement or Replacement?

By dedicating it to education, there is an implied promise that the lottery will increase school aid. This has never happened in New York. The legislative debates on the lottery in the early 1960s consistently described the lottery as being dedicated to education, but promises that it would actually increase the aid that schools would have received anyway were not generally made. Efforts to ensure that the lottery would serve as a supplement were not visible until after the voters had approved the lottery. Over the years, **governors** have consistently contributed to the popular perception that the lottery provided additional funding.

The lottery was approved during a period when state government spending and public school enrollment were both increasing rapidly. Short-sighted budget actions resulted in the need to raise revenues substantially; the lottery was approved by the Legislature after it acted to increase taxes — including imposition of a 2 percent sales tax — by nineteen percent.

State budgets and Lottery Division marketing materials have consistently referred to the lottery as being used “in support of education.” However, there has never been a real effort in the state's school aid formula to provide that lottery funds would be a supplement, although such “maintenance of effort” provisions have been employed for other dedicated revenue sources. In

fact, an examination of the aid formula demonstrates that the lottery does not affect total aid received by schools.

The evidence that the lottery is no different from other revenue sources is bolstered by examining past instances when the lottery was used to close budget gaps. These actions have been taken by at least three governors, starting in the year that the lottery was implemented. For example, in 1967, Governor Rockefeller partially funded previously enacted school aid increases with the new lottery.

Introduction

New York is one of 37 states that operates a lottery. In New York, the lottery generated \$1.6 billion for education in state fiscal year 1996-97, or 3.7 percent of state funds spending. The lottery provides about the same level of resources as the state's corporate tax on utilities and telephone companies, and slightly less than the amount collected from the cigarette and motor fuel, real estate transfer, and highway use taxes combined.

In short, the lottery is an important state revenue source and its absence would result in significant budget reductions or tax increases.

An important issue with the lottery is how it benefits education funding in the state. New York, like most of the other states that operate lotteries, dedicates proceeds to a specific use.¹ Although dedicating lottery proceeds — to education in most states and New York — is an effective means to gain public approval for lotteries, there is no conclusive evidence that the activity thus funded benefits.² The central question in New York is whether the lottery actually **supplements** what schools would otherwise receive or whether the lottery merely **supplants** spending that would have gone to schools.

Although the lottery is a significant source of revenue, spending on aid to public schools is much larger. In 1996-97, school aid totaled \$10.2 billion, or 23 percent of state funds spending. The lottery accounted for only 16 percent of the funds needed for school aid.

This report will describe how the lottery operates in New York; review the historical setting that surrounded the debate over permitting a lottery in the mid-1960s; review the contribution of the state, the lottery, and local school property taxpayers over time to school spending; describe how the state budgets lottery proceeds; and analyze recent changes to the lottery statute to determine legislative intent behind the changes.

The Historical Setting for Lottery Approval

A lottery was approved by New York's voters on November 8, 1966 by a 3 to 2 margin. The Legislature had first approved the amendment in 1965 and gave it second passage early in 1966 before it was put to the voters. An understanding of the state's financial condition in the mid- 1960s is important to understand the policy debate that accompanied approval of the lottery.

¹"The Game of Mystery Bucks", *Governing*. January 1998. pages 20-21.

²Donald E. Miller and Patrick A. Pierce, "Lotteries for Education: Windfall or Hoax?", *State and Local Government Review*. Winter 1997.

Spending and Revenues

Spending on public schools was increasing rapidly in the early 1960s, driven by both sharp increases in enrollment and reforms in the state's school aid formula. The 3.1 million enrolled pupils in 1964-65 represented a 19 percent increase over the 2.62 million in 1958-59.³ Growth in enrollment in the early 1960s was much greater than any period since: it far **outpaced** the growth during the second half of the 1960s. In contrast, enrollment declined for most of the 1970s and 1980s and has been growing relatively slowly in recent **years**.⁴

State spending in 1961-62 and 1962-63 grew by over 11 percent in each year, followed by 7 percent growth in 1963-64 and 4 percent in 1964-65. The growth in 1964-65 was only possible by accelerating the timing ("spinning up" or "one-shot" in 1990's revenue raising parlance) of corporate tax collections.

Because the acceleration did not recur in 1965-66, a number of revenue raisers were proposed and adopted in Governor Rockefeller's budget for that year, including imposition of a new 2 percent sales tax, increasing cigarette taxes by 5 cents per pack, and doubling motor vehicle registration fees. The value of these tax and fee increases totaled \$530 million, or 19 percent of then current-law's **revenues**.⁵

First passage of the constitutional amendment occurred in June 1965, during the same legislative session that required the nearly 20 percent tax and fee increases to bring the budget into balance.

The Lottery Debate

Was there a promise that lottery would provide additional support for schools? The record of the legislative debate and press coverage is not conclusive. Clearly, the primary focus was on whether the lottery — a form of gambling — was an appropriate source of revenue for government. Two editorials in the *New York Times* prior to legislative adoption of the proposed constitutional amendment focused on the moral **issue**.⁶

³1964-65 Executive Budget, page 639.

⁴1997 *New York State Statistical Yearbook*, 22nd Edition, p. 320.

⁵1965-66 Executive Budget, pages M22-M24.

⁶"A State Lottery?" *New York Times*, June 16, 1965; "Legalizing the Lottery." *New York Times*, January 27, 1966.

The Regents publicly announced opposition to the lottery in August 1966.⁷ Their position was reported to stem from the moral question of gambling and from opposition to the concept of dedicating revenue to specific uses. They must also have expressed concern that the lottery would replace existing General Fund support; a *New York Times* editorial from February 1967 — after the amendment had been approved — took issue with plans to use the lottery to replace existing funding. The editorial stated that the Regents had cited this as a concern before the referendum was adopted.

Lottery Revenues and School Aid Payments

From the inception of the lottery, certain calculations have been employed to distribute lottery payments to schools. In actuality, however, none of these mechanisms has really been used to apportion aid, they have only served as an artificial accounting device. This happens because the lottery revenues are simply deducted from the general revenues flowing to schools. The decisions about how much aid to allocate and how to apportion it among school districts are simply not impacted by the lottery earnings.

In New York, state aid is apportioned to school districts through a complex web of formulas. In all, there are more than 40 formula and grant programs, many of which are altered annually in the budget enacted by the Legislature.⁸ Each year the aid allocation is driven by negotiations about the size of the increase overall and regional shares of aid. The legislators themselves and the Executive typically only focus on the broad figures, and the annual alterations to the formulas are carried out by a small group of technicians who are conversant with the mechanics of the aid distribution. Although the lottery revenues partially support each year's aid, there is no direct relationship between these revenues and either the overall amount of aid allocated, or its distribution among individual school districts.

This situation is not always readily admitted, however, and some descriptions of the aid system, while being technically correct, nevertheless provide an incorrect impression that the lottery earnings really do influence the amounts of aid school districts receive.⁹ For example, the Division of the Lottery annually publishes lists of lottery aid amounts received by each school district. Although these listings correctly reflect the lottery aid calculations specified in law, they provide a misleading impression because they do not include a description of how the amounts

⁷“Regents opposed to Lottery Plan.” *New York Times*, August 27, 1966.

⁸For a description of the aid system the manner in which it has become so complex, and problems inherent such a system, the reader is referred to *An Agenda for Equitable and Cost-Effective School Finance Reform*, Office of the State Comptroller, October 1996.

⁹The lottery formula is actually quite simple in calculation and provides an unambiguous distribution aimed at equalizing local differences in property wealth. It may be of interest to note that if this formula were truly applied, it would allocate 39 percent of aid funds to New York City, more than the 35 percent share the City receives.

so calculated are simply deducted from the aid distribution calculated under the balance of the school aid formula system.

Two mechanisms are used to apportion lottery receipts to individual school districts, a textbook aid calculation and a general formula allocation. These are the figures reflected in the Lottery Division's publications, and both are of longstanding use in connection with lottery revenues.

Reimbursement for textbook purchases is provided through a formula which provides up to \$40.90 per pupil for textbooks purchased and used in public schools or loaned for use to private school pupils. A portion of this reimbursement equal to \$15 per pupil is provided through lottery revenues. The remainder, \$25.90 per pupil, is paid from General Fund resources. However, the overall amount of money provided for textbooks is driven by the \$40.90 maximum allocation — the fact that a portion of this funding is provided through lottery revenues **really** doesn't change anything for school districts.

The preponderance of the lottery funds are funneled through an obscure "lottery formula" which theoretically calculates the aid amounts going to school districts based on an aid ratio, the number of pupils in each district and the lottery funds appropriated overall. In actuality, however, this formula has no impact on aid received *because the amounts calculated through it are literally **deducted from** the amounts calculated under other aid **formulas**. In every case, this* aid calculation equals an amount less than the sum of the other aid formulas, and the lottery aid calculation thus has absolutely no impact on the annual aid **allocation** each district receives."

Further evidence that the lottery has no impact on aid distributions is supplied by the aid tables and computer runs distributed by the Education Department and the Executive. These publications do not make distinctions between lottery revenues and General Fund aid in the central tables describing the aid distribution; the amount of aid to be funded through lottery revenues is only a technical issue for those concerned with the state fiscal year appropriation needs or the most detailed levels of the payment schedule.

Another portion of lottery funds is provided explicitly for the education of blind and deaf pupils (these funds do not, however, flow to school districts directly). Similar to the case for textbooks, however, this linkage between lottery revenues and the program is not real. The aid for textbooks and blind and deaf pupils would be provided with or without the lottery revenues. In New York State and other states, lottery revenues have been tied to education in an attempt to counterbalance the negative image of funds earned from profits on gambling. Textbooks and blind and deaf students are an extension of this effort, for it is **difficult** to imagine more

"However, the amounts calculated in this manner do have a small impact on the timing of aid payments, because the September payment to school districts is based on this calculation, but subsequent aid payments are **based** on the remainder of aid due under the formulas (**after** deducting the September payment).

worthwhile expenditures to offset the negative impression many citizens have of governmental revenues derived from gambling.

The purpose of this section has been to describe the seemingly contradictory facts that while actual calculations involving lottery aid are made, they do not affect the overall aid going to school districts. The purpose is not to suggest that some different formula approach would solve the problem. For example, even if lottery receipts did flow through a completely separate (and operating) supplemental school aid formula, the budget negotiators each year would look at how much was going out through that formula and where it was going, and then they would decide what to do with the remaining formulas. School aid decisions have always been made apart from the lottery revenues and it is unlikely that any sort of statutory or constitutional amendment would change this.

The Lottery as a Revenue Raiser

New York's lottery has often been tapped as a source for closing budget gaps, a practice which makes it very clear that the lottery does not act as a supplement for state aid to schools. The most recent example of this occurred in Governor Pataki's 1995-96 budget when a new game was proposed, **QuickDraw**. Despite an increase in lottery revenues that would result from the new game, the Executive Budget proposed cutting school aid by \$90 million.

In 1996-97, the Executive Budget proposed reducing school aid by \$117 million." The budget also assumed that **QuickDraw**, which would be operational for a full year, would contribute to an estimated \$69 million increase in net lottery receipts." Despite this projected increase in lottery revenues, the Executive Budget proposed a school aid decrease.

The combination of increasing lottery receipts and proposed cuts in school aid is not a recent phenomenon. In 1991-92, Governor Cuomo's Executive Budget proposed legislation altering the prize structure of certain lottery games that would increase net receipts by \$10 million." At the same time, aid to public schools was proposed to be reduced by \$891 million."

The notion that the lottery was a source of revenue to support education spending, but not necessarily supplementing previous commitments, was expressed during the first year that the lottery became operational. The state budget for 1967-68 was constrained by a \$284 million increase in local assistance that had been adopted the previous year but whose implementation

"Office of the State Comptroller, *Fiscal Review of the 1996-97 Executive Budget*, January 8, 1996, p. 29.

¹²1996-97 *Executive Budget*. Appendix II, p. 182.

¹³1991-92 *Executive Budget*, *Annual Message*. p. A98-A99.

¹⁴1991-92 *Executive Budget*, p. 327.

was delayed by one year. Although the aid increase was put in place without certainty that the voters would approve a lottery, and without being contingent on the lottery providing funds, the lottery was seen as a means to pay for the previous commitment, rather than as a source of supplementing the existing formula.

Governor Rockefeller's 1967-68 Executive Budget stated that "the Lottery funds will help to finance a part of our greatly expanded educational costs." Assembly Speaker Travia suggested a similar use for the lottery, when he identified it as a means to fund the prior commitment to increased school aid.¹⁶

School Finance Trends

In order to measure the role of the lottery in school finances, two sets of historical information were prepared for this report.

State Share of Resources to Public Schools

Table 1 documents state spending between fiscal years 1960-61 and 1996-97. The table includes:

- ✓ Total General Fund spending. Although this is not a complete measure of state spending, because it excludes federal funds and dedicated state revenue sources, it is the **only** data that can be constructed consistently over a long time period.
- ✓ Expenses for administering the lottery; note that these figures were inconsistently reported in financial documents and are not available for many years.
- ✓ General Fund School Aid. This column contains disbursements in each state fiscal year (which does not coincide with school years). Spending from the Educational Assistance Revolving Account (EARA) and the Local Government Assistance Corporation was added to the General Fund figure. EARA was used to put aside funds for school aid payments to be disbursed in the following year. LGAC accelerated the timing of payments.
- ✓ Lottery Aid to Public Schools. This column contains funds from the lottery special revenue fund that were disbursed to public schools. This amount should be added to the Local Assistance to Public Schools column to determine total school aid.

¹⁵ 1967-68 *Executive Budget*, p. M 17-M 18.

¹⁶ "No Tax Rise Seen for State till '69," *New York Times*, December 15, 1966.

The last three columns calculate the share of various components of spending.

- ✓ General Fund School Aid as a percent of total General Fund Spending calculates the share of total General Fund spending that went to school aid. It excludes lottery spending.

Analysis of the trends in this column show that school aid accounted for about 35 percent of General Fund spending prior to the introduction of the lottery. After the introduction of the lottery, school aid's share of General Fund spending declined until the mid- 1980s, when it was a low of 23 percent of spending. It has since increased to about 28 percent. The figures in the early 1990s show some large swings as the timing of payments was modified. These year-to-year changes should be ignored.

- ✓ General Fund School Aid + Lottery as a Percent of General Fund and Lottery Spending takes total school aid spending (both the General Fund and the lottery amounts) and calculates their share of General Fund and lottery receipts.

When compared to the General Fund-only data, this column shows a less pronounced decline in the share of spending allocated to school aid. Because this column includes lottery, this suggests that the lottery served to replace existing aid.

- ✓ Lottery's Share of Total School Aid. This column calculates lottery as a percent of total school aid (General Fund and lottery).

A significant problem with this series of data is that it does not adjust for the many changes that have taken place in state finances since the early 1960s. For example, with the expansion of the State University system and state assumption of a portion of CUNY funding, spending on SUNY increased from 2.4 percent of General Fund spending in 1960-61 to 1996-97's 6.2 percent that went to SUNY and CUNY. Health and Mental Hygiene accounted for 17.6 percent of spending in 1960-61 and 21.2 percent of spending in 1996-97. There were many other changes over the period, including state assumption of local courts and growth in public assistance caseloads, that represented structural shifts in state finances. As a result, as the number of functions that state government performed increased and school enrollment declined, it could be expected that the state would not necessarily dedicate the same share of spending to school aid.

The lottery's contribution to school spending was relatively modest until the early 1980s, when lottery revenues began to grow substantially. The growth was driven by restructuring prizes and the introduction of new, more popular games.

Lottery receipts have grown at a much faster pace than the General Fund portion of school aid. During the 12 year period from 1970 to 1981, the lottery increased 285 percent compared to an 84 percent increase in General Fund school aid. The pace accelerated in the next

12 year period, when lottery increased by 482 percent and General Fund school aid increased by only 90 percent.

*Despite the difficulty in comparing shares of spending **from** the early 1960s to the present, it is clear that the lottery has not acted as a supplement to school aid. General Fund support to public schools has not nearly kept pace with lottery's contribution and the share of school aid to total spending has declined significantly.*

